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SCOTTSDALE CITY COUNCIL

Sam Kathryn Campana, Mayor
Councilwoman Cynthia Lukas
Councilwoman Mary Manross
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Councilman Dennis Robbins
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Councilman George Zraket

**EVALUATION OF RURAL/METRO CONTRACT
COMPLIANCE**

The City Auditor evaluated the Rural/Metro contract and found that Rural/Metro complies with all of the major contract requirements.

**Report No. 9406
September 1998**



September 4, 1998

To the Most Honorable Sam Kathryn Campana, Mayor
and the Members of the Scottsdale City Council:

Transmitted herewith is the report of our evaluation of contract compliance related to the contract which the City has with the Rural/Metro Fire Department for fire and emergency services, *Evaluation Of Rural/Metro Contract Compliance*, Report No. 9406. This audit was a scheduled project approved by City Council. Ramon Ramirez was the auditor in charge.

As a result of our audit work, nothing came to our attention that caused us to believe that the Rural/Metro Fire Department failed to comply with any material provision of the contract. If you need additional information or have any questions, please feel free to contact us at 994-7756.

Respectfully submitted,

A handwritten signature in cursive script that reads "Cheryl Lu Barcala".

Cheryl Barcala, CIA, CPA, CFE, CGFM
City Auditor

Evaluation Of Rural/Metro Contract Compliance

Report No. 9406

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Evaluation Of Rural/Metro Contract Compliance Action Plan (No. 9406)

No.	MANAGEMENT RESPONSE		IMPLEMENTATION STATUS		RECOMMENDATION(S)
	AGREE	DISAGREE	UNDERWAY	PLANNED	
1	X		X		The City Manager should require: The Contract Administrator to obtain all contractually required reports from Rural/Metro.
2	X		X		Development of a performance criterion for use in assessing the total Rural/Metro response time, unit notification to arrival on scene.
3	X		X		The Contract Administrator to maintain and update the contract document to reflect additions and changes to the contract terms.
4	X		X		Development of penalties for noncompliance with contractually required performance criteria.
5	X		X		Certification that Year 2000 issues will not interrupt services provided to the City, through modifying the contract, and development of a City contingency plan in the event of failure.
6	X		X		Development of a process to stringently review the annual cost of fire and emergency services, including clarifying the methods, definitions, terms and formulas to be used in calculating the annual fee, such as including a clear distinction in maintenance roles and responsibilities; specific performance criteria which could be tied to the level of funding; depreciation; equipment ownership and disposal funds from the sale or transfer of equipment; interest charges; response debit/credit amounts; and Limited Life Purchase Agreements.

**Evaluation Of Rural/Metro Contract Compliance
Action Plan (No. 9406)**

No.	MANAGEMENT RESPONSE		IMPLEMENTATION STATUS		RECOMMENDATION(S)
	AGREE	DISAGREE	UNDERWAY	PLANNED	
7	X		X		Development and documentation of methodology for calculating the service level increases.
8	X		X		Evaluation of the need for allowing Rural/Metro to include a service fee in the annual fee, and if approved, require documentation of the methodology.
9	X		X		Documentation of the justification for other related costs such as consumable supplies. Rural/Metro should be required to certify that the items purchased with City funds were used in the normal course of providing fire protection services within Scottsdale city limits, and that the cost of such supplies will not be passed on through other Rural/Metro fees and charges.

CHAPTER ONE

Evaluation of Rural/Metro Contract Compliance
City Auditor Report No. 9406

Introduction

This report details the results of an audit of the City's contract with the Rural/Metro Fire Department for the provision of fire protection and emergency response services. The audit was requested by the Police Chief/Director of Public Safety (Police Chief) in 1995. At that time, the City was in the last year of a multi-year contract which required notification of the intent to renew no later than January 1996. Due to the compressed time line, our office conducted a preliminary survey of the contract, and discussed initial points of concern with the Police Chief and the Contract Administrator in December 1995.

At that time, it was agreed that the City would notify Rural/Metro of the intent to exercise the 5-year extension provision included in the contract. The City could then use the period between 1996 to 2001 to develop a strategic plan related to the provision of fire services, and work toward strengthening the management of the contract. It was also agreed that during this time period, our office would complete the audit.

This audit was completed, with the approval of the Mayor and City Council, to gain insights that may be used to strengthen and refine the contract and its administration. The work evaluated the contract document and its administration within the City, and verified Rural/Metro's compliance with significant performance measures set out in the contract. Because the audit was designed to evaluate the contract and its administration, not the operations of Rural/Metro, we did not examine or comment on the quality of services provided. Objectives, scope, and method of the audit are discussed in Appendix A.

Results In Brief

The results of our audit indicate that Rural/Metro complies with all of the major requirements of the contract, and the arrangement appears to be functioning well. Interviews with officials from both organizations characterized the relationship as a successful long-term partnership that is based on mutual understanding, and that focuses on the best interests of the citizens in Scottsdale.

According to City and Rural/Metro staff, the contract's intent is for Rural/Metro staff to work closely with City staff in carrying out the normal duties of a fire department. This appears to be working as intended. The Rural/Metro Fire Chief is a participant on the City Manager's Executive Team. Rural/Metro staff work side-by-side with City staff in the City's

Plan Review Department to facilitate building plan reviews and inspections. Rural/Metro staff spearhead the City's emergency response and disaster recovery programs, and the Rural/Metro complex serves as the primary emergency response staging facility. Rural/Metro and the City Police Department share the use of a joint training facility.

Rural/Metro also has addressed fire prevention and awareness issues within the City, as well as implemented modern fire response techniques. The results of these efforts are demonstrated in the national recognition received by the City for its sprinkler ordinance, originally established in 1974 with Rural/Metro support, and strengthened in 1984. It was also evidenced in an outside consultant evaluation, completed in 1989, that described Rural/Metro as "one of the best departments that we have had an opportunity to review."

More recently, Rural/Metro applied for an improved insurance premium rating for the City. This rating is used by insurance companies as the basis for determining insurance premiums that will be charged to the citizens of Scottsdale. The decision to upgrade the rating was made by the Insurance Services Office, and was based on reviews of fire facilities, the fire personnel training program, placement of hydrants and sprinklers, and other response-related items such as the Computer-Aided Dispatch (CAD) system. As a result of this review process, Rural/Metro received preliminary notice that the rating would be improved from a 4 to a 3 on a scale of 1 to 10, with 1 being the best rating.

During our audit, we identified opportunities to enhance the measurement of Rural/Metro performance, by strengthening reports, establishing a total response time measure, keeping the contractual measures up to date, and developing non-compliance penalties. We also identified opportunities to strengthen the relationship by addressing the potential effect of Year 2000 on automation related to service delivery, and improving documentation related to the determination of Rural/Metro's annual fee.

Background

For municipalities, fire and emergency services are commonly provided through municipal or volunteer fire departments. Within the City of Scottsdale, these services are provided through a contract with Rural/Metro, a for-profit private sector service provider. Rural/Metro started providing subscription (individually contracted) fire protection services in the area in 1948 when Scottsdale had a population of 2,000. In 1951, after Scottsdale's incorporation, City officials decided to establish a

contractual relationship with Rural/Metro to provide fire protection services to the citizens, as opposed to creating a municipal fire department. Under this contractual arrangement, the City provides the fire stations and some of the large fire fighting apparatus. Rural/Metro provides the personnel to staff the fire stations, equips the stations, provides staff to develop and implement the fire prevention programs, and handles all of the administrative issues related to providing the service. They also provide some of the large apparatus and the necessary staff vehicles.

The fact that Rural/Metro provides a wide range of services throughout Arizona and the nation, is seen as one of the most positive aspects of the relationship, according to City officials. In addition to providing service to the City, Rural/Metro also separately contracts to provide fire protection for Fountain Hills, as well as subscription fire protection services for residents in Paradise Valley and various other municipalities and counties in Arizona. In 1993, Rural/Metro became a publicly traded corporation. The last three years have seen an increase in the national operations of the parent corporation.

The City's Contract Administrator stated that he believes the City benefits from cross-training and cross-utilization of personnel from other divisions within the company. This allows fire stations to be staffed with the minimum level of support, while having on-call response to incidents requiring a higher level of support. Crews from stations outside the Scottsdale area can be moved into the City to cover calls. Likewise, crews from Scottsdale can be used to help cover situations in surrounding communities. The cost to the City for expenses such as operating the CAD, training, and other administrative duties, is reduced, according to the Contract Administrator, because there is a larger client base using these services.

Previous Rural/Metro Reviews

In 1989, the City hired an outside consultant, University City Science Center, to evaluate the fire and emergency services provided to the citizens of Scottsdale. According to the report, the review was an outgrowth of concern, at that time, regarding the capability, quality, and capacity of the City's system for providing fire and emergency medical services (EMS).

The consultant's overall assessment was that the companies providing the services "are performing well and are providing citizens with a good level of care." Specifically related to Rural/Metro, the consultant stated "Our overall assessment of the Department is that it is well managed, capable and progressive." The consultant evaluated Rural/Metro fire

and EMS, three independent private ambulance and paramedic service providers, interviewed City staff, Rural/Metro employees, personnel from the emergency medical profession, conducted site visits, analyzed service trends for the previous 5-year period and projections for the next 5 years, as well as actual responses for the immediate preceding year.

The consultant also evaluated a citizen-generated proposal for a municipal fire department. Other than stating that the proposal significantly underestimated the personnel needs and costs of a municipal department, the consultant did not come to a conclusion on whether one type of service provider was better than another. The report stated that, "The proposal would increase the cost of services by 75 percent and would not lead to a service improvement in the community."

As part of the report, the consultant made recommendations to the City as well as to Rural/Metro. A new contract, the subject of this audit, and the establishment of an emergency services officer position, are outcomes of those recommendations. Specific to those recommendations was an increase in the level of funding which was intended to help Rural/Metro attract and retain qualified personnel. This recommendation was the result of the consultant's finding that, at that time, Rural/Metro's annual mid-range pay was 20 percent lower than other fire departments in the area.

Additionally, according to the Police Chief, a citizen review of Rural/Metro efficiencies in 1993 predicated the decision to allow Rural/Metro to become the sole Scottsdale EMS provider. The Police Chief stated that this process represented another public forum that positively evaluated Rural/Metro-provided services.

The Current City Contract

The current City contract with Rural/Metro is a multi-year contract, for the period Fiscal Year (FY) 1996/97 to FY 2000/01, which was awarded on a "sole source" basis, the process the City uses when it determines, after research, that there is only one source for the required material or service. Sole source contracts thus are not awarded through competition. The contract requires Rural/Metro to respond to the types of incidents shown in the Insert on the next page, as well as to provide fire prevention and fire education services.

Incidents To Which Rural/Metro Responds

- ◆ Provide fire suppression services related to reports of fire or smoke.
- ◆ Provide emergency assistance, including situations involving trapped persons and other non-medical rescues.
- ◆ Reports of unconfined hazardous material.
- ◆ Airport alerts, including uncontrolled aircraft landings, and reports of mechanical problems in aircraft prior to landing.
- ◆ Provide advanced life support medical care and/or ambulance transport services to reports of civilian injury or illness.
- ◆ Service incident requests, including but not limited to, invalid assistance, water problems, dangerous animal removal, sprinkler activation without fire, trapped animal, and odor checks.

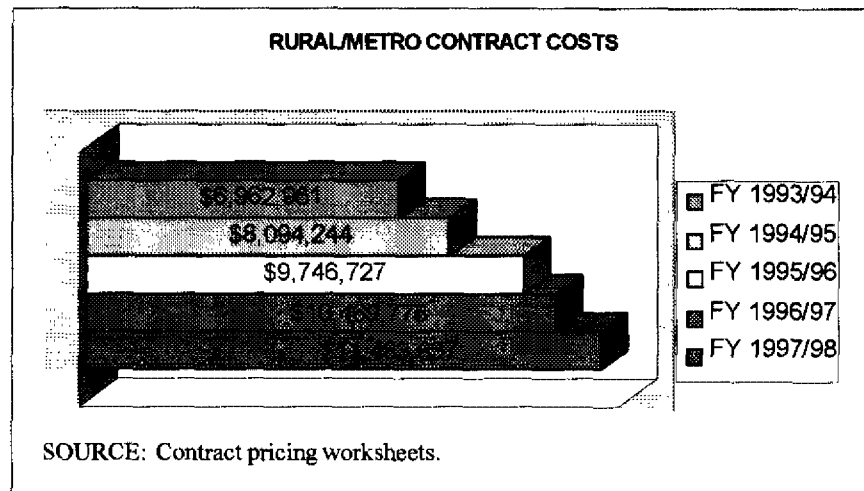
SOURCE: Audit analysis of the City's contract with Rural/Metro.

The contract also sets out the minimum apparatus and personnel that Rural/Metro will respond with, and response time standards. In addition, the contract sets minimum certification and training levels for Rural/Metro personnel, and outlines the minimum level of administrative personnel support. Under the terms of the contract, the City is responsible for building and maintaining the fire stations, while Rural/Metro is responsible for equipping the stations and maintaining the interior and the outside landscaping. The contract allows Rural/Metro to replace and own any vehicle or item of equipment, with City approval, if they owned it prior to the start of the contract.

In terms of contract pricing (the City cost), the contract contains a "Funding Plan" which, along with requests for increases in service levels, was intended for use in determining the annual contract price after the initial contract year. While the contract specifically states that it is a fixed-price contract, the structure is actually a hybrid of fixed-price and cost-plus, because it contains provisions to pass on costs directly to the City.

Calculation of the contract price for a particular year starts with the contract price from the previous year. The wage portion of the previous contract price can be increased by the average percent increases provided

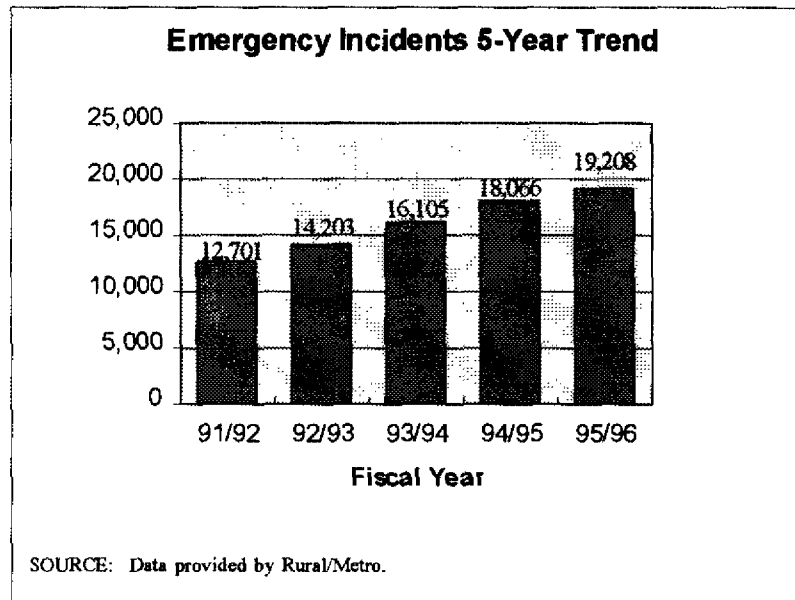
to fire personnel in the surrounding area. Then, the expense base portion of the previous contract price can be increased by a percent equal to the area's Consumer Price Index (CPI). Contract pricing then allows for the addition of interest, depreciation, and other direct costs. Increases in service levels are determined each year based on staffing needs. The chart below shows the growth in the contract price for the last five years.



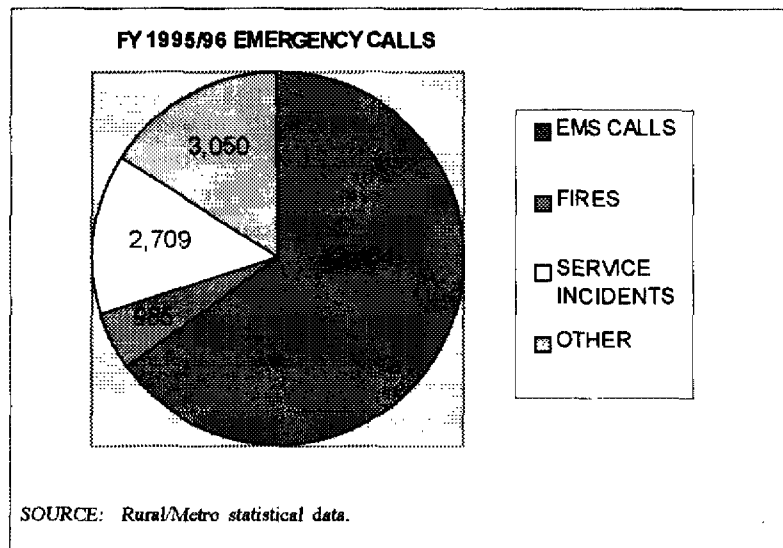
Since the inception of the contract, there have been several modifications. The most significant modification occurred in September 1993, when Rural/Metro was established as the sole provider of all advanced life support emergency medical care, including transport capabilities (ambulance services) within the City. This decision came, in part, from recommendations in the 1989 evaluation to: 1) establish performance measures for service providers; 2) monitor compliance and service performance; 3) assign advanced care responsibilities to the fire engine companies as a means of providing faster advanced emergency care; and 4) coordinate fire and ambulance services.

After reviewing the issues, Rural/Metro proposed to take on providing what traditionally were considered ambulance services. The proposal carried several benefits for the City. One position on each engine would be upgraded to a paramedic, allowing the engine company to provide advanced life support without increasing personnel costs. Response to calls could be coordinated, and two paramedics could respond with transport vehicles housed in stations. The City would monitor one company, not several, for compliance. Other changes in contract scope include relinquishing control of the Fire Support Program to Rural/Metro, and changing the fire station utilities payment process.

Incident Response During the period covered by our audit, fire protection services were based from nine fire stations, eight of which were City-owned, and one a Rural/Metro-owned station located in the county. An additional City-owned station was planned for start-up in January 1998. Ownership of the large fire apparatus was split about equally between the City and Rural/Metro. The Rural/Metro service area consists of the approximately 183 square miles in Scottsdale. In this area, there are approximately 94,000 housing units with an estimated population of 183,000. This represents an increase of more than 35,000, or 25 percent, since FY 1991/92. The increase in population also has been associated with an increase in the number of emergency incidents, with the number of calls rising from 12,701 in FY 1991/92 to 19,208 in FY 1995/96, a 51 percent increase. The graph below illustrates the increase in emergency incidents in the last five years.



Incident types can be generally classified as fire calls, EMS calls, service incidents, and others. During FY 1995/96 Rural/Metro responded to 19,208 calls. The following chart indicates the breakout of those calls by incident type.



CHAPTER TWO

Evaluation of Rural/Metro Contract Compliance
City Auditor Report No. 9406

Rural/Metro Contract Compliance

The relationship between the City and Rural/Metro is long-standing, with both City and Rural/Metro staff characterizing it as a "friendly partnership," one that has benefited both the City and Rural/Metro. In effect, because of the length of the relationship, the City and Rural/Metro have grown up together. During this time period, the City has become more adept and professional in delivery of services just as Rural/Metro has. Because the two parties have worked closely together, there is a good working relationship, and "corporate cultures" that work well together.

This review focused on the internal control aspect of the contractual arrangement. We completed this evaluation with the following goals in mind:

- ♦ Identify issues relating to the contract which will need to be addressed prior to approving a new contract amount or negotiating a new contract.
- ♦ Identify issues that will strengthen the City's approach to strategic planning, which need to be addressed prior to negotiating a new contract.
- ♦ Identify enhancements to contract administration which will improve monitoring of the contract.

As a result of our audit work, nothing came to our attention that caused us to believe that the Rural/Metro Fire Department failed to comply with any material provision of the contract. We did identify opportunities to strengthen the internal controls related to the contract, by enhancing performance measures and reports, addressing the effect of Year 2000 on automation related to service delivery, and improving documentation related to the determination of Rural/Metro's annual fee. Each of these issues will be discussed below.

Rural/Metro Is In Significant Compliance With Performance Measures

One of the methods used in contractual arrangements to ensure that the City receives the level of services originally bargained for is the establishment of performance measures which can be used to monitor service delivery. Inclusion of these measurements provides both the contractor and the City with documentation of the type of services and frequency desired. Good performance measures are developed so that they are related to the expected outcomes. Evaluating performance helps assure that the expected outcome will be achieved.

The Rural/Metro contract contains performance measures relating to staff qualifications and continuing education, staffing levels, equipment levels, education and outreach programs, and response times. The Contract Administrator uses several of these performance measures to monitor Rural/Metro's compliance. He does not verify staff qualifications or training requirements.

During our audit, we verified that Rural/Metro was in significant compliance with the performance measures outlined in the contract. We also identified opportunities to enhance the measurement of Rural/Metro performance, by strengthening reports, establishing a total response time measure, keeping the contractual measures up to date, and developing non-compliance penalties. The results of those verifications are discussed below.

**Training And Certification
Requirements Appear
To Be Met**

The Rural/Metro contract contains specific requirements related to staff qualifications and continuing education requirements to assure that the firefighters and paramedics that respond to calls are qualified and current on the latest techniques. The contract requires that *"All full-time fire fighters shall hold the Fire Fighter II level of certification and State Emergency Medical Technician (EMT) Certification, when working within the Scottsdale service area."* Additionally, Rural/Metro is required to *"provide a minimum of 240 hours of training each year of service to all full-time fire fighters."*

We verified Rural/Metro compliance with the certification requirements. To verify compliance with the Fire Fighter II certification requirement, we contacted the State Fire Marshall's Office and obtained the level and date of certification for a sample of full-time Rural/Metro firefighters working within the City. To verify compliance with the EMT certification requirement, we contacted the Arizona Department of Health Services, and obtained the certificate expiration date for a sample of full-time Rural/Metro firefighters working within the City. In both cases, we found compliance with the certification requirements.

We also verified compliance with the 240-hour training requirement for a sample of firefighters. We found that the process for this verification was cumbersome and time consuming because, in past years, Rural/Metro did not have a centralized system for tracking employee training. The firefighter training records were maintained at the various stations at which the training was given. As a result, it was difficult to obtain a summary of training for a particular individual, or to access the related

training documentation. Rural/Metro recently has implemented a centralized training system that, based on preliminary review, appears to address these obstacles.

**Response Time Requirements
Appear To Be Met,
But Reporting Needs
Improvement**

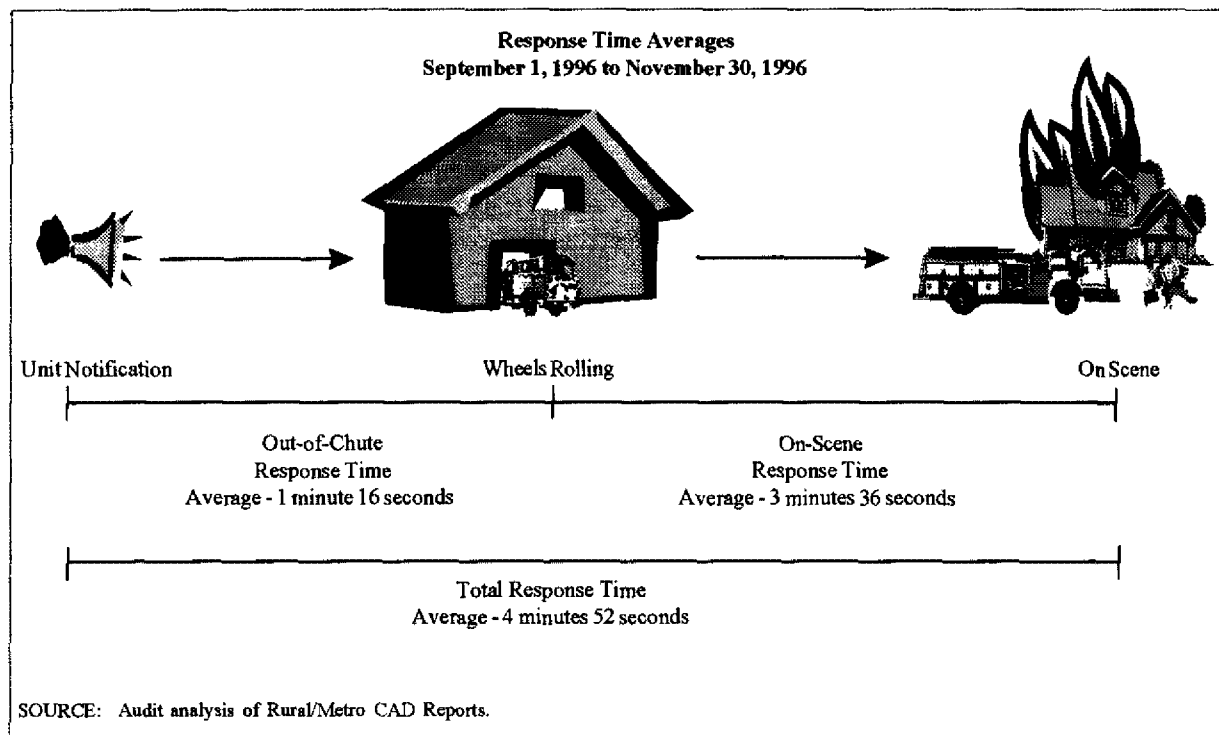
The other significant performance measure related to the quality of service provided by Rural/Metro relates to the response time requirements. Response time is established in the contract because it is a community-based decision. Nationally accepted response time goals do not exist. The community goal is based on several factors, including the American Heart Association's data on the amount of time that the brain is deprived of oxygen before permanent brain damage. Local factors such as the City's sprinkler ordinance, and the mixture of dense and sparse population areas, also affect the decision in developing measures.

Response time requirements in the contract consist of two different measures. One element measures the time period between unit notification of a call and the time unit wheels begin rolling (out-of-chute response time). The other element measures the period of time between when the emergency unit goes en route to an emergency call (when wheels begin rolling) to the time that the first piece of emergency or fire apparatus arrives at the call (on-scene response time). The contract requires Rural/Metro to provide the City with monthly reports that indicate their response time performance related to these two elements. Response time criteria is tailored for each geographic location and the time of day at which an incident is reported. For example, response time for primary areas covered by stations 10 and 11 is 4 minutes or less, and on-scene, 90 percent of the time.

We reviewed a 3-month period beginning September 1, 1996, and ending November 30, 1996. For that period, we found that the contractual out-of-chute response criteria was not complied with in 52.6 percent of the calls. We do not believe that noncompliance with the out-of-chute criteria necessarily indicates a performance problem, because it may not signal that Rural/Metro was late arriving at the incident. At the same time, on-scene response within the contract requirements may not signal that Rural/Metro arrived at the incident in a timely manner. Assessment of whether or not an issue exists related to Rural/Metro response time requires measurement to a criterion for the total time it took to respond.

For the 3-month period reviewed, we determined Rural/Metro's average total response time by combining their out-of-chute and on-scene times. The average total response time was 4 minutes 52 seconds. Although the

time of day and the responding station determine the response time criteria, the minimum response time that could apply is 5 minutes. As a result, Rural/Metro's response time performance during the period reviewed does not appear to be cause for concern. The results of our response time analysis are presented in the chart below.



Based on our review of the information provided, we believe that Rural/Metro is in significant compliance with the response time criteria. We did note however, four issues that we believe need to be addressed. These relate to providing the required reports, establishing a more effective performance measure, keeping the performance criteria outlined in the contract current, and establishing penalties for non-compliance with response time criteria. These issues will be addressed in the following sections.

***Rural/Metro Should Provide
All Required Reports
Relating To Exceptions***

The contract outlines the process that Rural/Metro is to use in reporting response times and exceptions. Each month Rural/Metro is to provide reports that outline:

- ♦ Response time performance for primary service area.
- ♦ Exception reports.
- ♦ Responses out of primary service area:
 - ♦ number of apparatus sent, and
 - ♦ total time out of area.
- ♦ Responses into primary service area from Rural Metro's other response area.
- ♦ Response time for each of the stations primary response area.
- ♦ Response time report which shows time call is received by Rural/Metro, time apparatus is gone en-route to the call, and time each emergency unit arrives on-the-scene.

During our audit, we asked the Contract Administrator for copies of the reports required by the contract. According to him, he has not received any reports from Rural/Metro with the exception of monthly summary reports which list, by station, the number of exceptions and the reason.

Rural/Metro was able to provide us with computer-generated reports that indicate calls by station with response times, responding apparatus and type of call. Reports were also provided that detailed calls by response area with time of call, address, equipment dispatched, and exceptions to on-scene response time.

We believe that Rural/Metro should provide all reports to the Contract Administrator as required by the contract. The summary reports which have been provided do not contain all the information required by the contract.

***Establishment Of A Total
Response Time Performance
Measure Would Be Beneficial***

The response time criteria outlined in the contract consist of two measures which are interrelated; the ending time for one measurement becomes the beginning time for the second. An error in correctly recording out-of-chute termination, results in an automatic error in on-scene initiation. For example, if a fire truck is not able to call in out-of-chute when leaving the station due to heavy radio traffic, that time may appear to be longer and the on-scene response time will be shorter.

During our audit, we found that Rural/Metro was not reporting exceptions to the "out-of-chute" response time criteria. According to Rural/Metro

officials, these exceptions are not reported because they do not believe the current system captures the correct "out-of-chute" time. They believe the errors occur because the measurement is based on the responding unit making a call to dispatch with a message that the unit is underway. Due to heavy air traffic that may occur during a call, it is sometimes difficult to promptly radio in. In these instances, the time that is noted as the point at which wheels begin rolling may be delayed. Rural/Metro officials stated that the two separate criteria were included in the contract because it was anticipated that computers would be installed in the trucks that would allow the time to be accurately captured. This has not occurred, so the time is recorded through a radio call.

As discussed earlier, the time called in when a unit leaves the station (wheels rolling) becomes the beginning time for the next measure. Any error in capturing that time would result in an error in the "on-scene" response time. Because of this, we believe that establishing a performance measure that tracks total response time, unit notification to arrival on scene, would be a more informative measure as it relates to the City's need. In addition, reporting the total response time, as opposed to breaking it into two measures, would reduce the likelihood of errors or data manipulation, and reduce the amount of time the Contract Administrator has to dedicate to monitoring related performance.

***Performance Criteria Outlined
In The Contract Should Reflect
The Most Recent Agreements***

Written documentation of agreed-upon criteria serves as a means of memorializing terms and conditions for which the parties in a contractual arrangement will be responsible. Written documentation also assures continuity in long-term agreements by providing necessary information to subsequent individuals responsible for monitoring contract performance or service delivery. Documentation of contract modifications should also occur timely to avoid disputes regarding established criteria. In the absence of documented evidence that both parties agreed to changes in terms or conditions, the original agreement would supersede any verbal understandings. Written documentation of the agreements also helps avoid erroneous conclusions regarding contract compliance when performance criteria are modified.

During our audit, we evaluated Rural/Metro's compliance with response times, and found that the criteria outlined in the contract did not reflect the performance measures that the Contract Administrator and Rural/Metro were using. According to the Contract Administrator and Rural/Metro officials, the criteria regarding fire and emergency response time was modified to reflect the agreed-upon criteria established for transport

(ambulance) response time in February 1994. The effect of this modification was to exclude all responses over 5 miles in length from the response time criteria.

Without immediately documenting agreed-upon contract changes, the contract administration cannot support the application of requirements different from the documented contract language. Without information to the contrary, a subsequent contract administrator would likely apply the standards as documented in the contract.

We believe that it would be in the best interest of both parties to adequately document agreed-upon contract modifications in a timely manner, and at a level equal to the care taken to document the original agreement. According to terms of the contract, modifications are not valid until the modification is filed with the City Clerk.

***Penalties For Response Time
Non-compliance Need
To Be Developed***

Penalty provisions in contractual arrangements are usually used as a means to encourage prompt compliance with performance measures. Generally, these provisions consist of a financial penalty which the contractor would incur if the expected performance is not achieved. Effective provisions usually have an escalation clause that results in the financial penalty increasing if the non-compliance continues. Penalty provisions also serve as a means for the City to re-coup any expenditures incurred to remedy the non-compliance or to recover any revenues lost due to the issue.

In July 1991, when the Rural/Metro contract was amended, a penalty provision was not developed. Instead, language was incorporated which indicated that, after 12 months of operations, the response time standards would be reviewed and modified, where appropriate, based on current information. Additionally, at that same time, a response time penalty provision was to be developed and incorporated into the contract. This provided both the City and Rural/Metro the ability to gather information that would allow the development of effective performance measures and penalty provisions.

In performing our audit, we found that, to date, no response time penalty provision has been incorporated into the contract. According to the Contract Administrator, agreement could not be reached with Rural/Metro on a penalty amount. Without a penalty provision, Rural/Metro does not have any financial motivation for timely conformance to contract requirements. Currently, the City can initiate termination of the contract

for default, but this may not motivate immediate performance to requirements. Under the default provision of the contract, Rural/Metro would have at least 120 days to cure the non-compliance and return to good standing. This action does not provide incentive for continuous compliance. Should performance problems reoccur, the City would have to initiate the default process again.

To provide the City a practical remedy to response time noncompliance, and Rural/Metro the incentive to comply, the penalty provision should be developed and incorporated into the contract. A response time penalty provision should clearly identify the conditions for application of the penalty, such as the type of calls to which it applies, allowable exceptions (if any), and the time periods/intervals to be reviewed for determining noncompliance. Additionally, it should include incentives for Rural/Metro to immediately address and correct response time problems. A penalty escalation factor, tied to the frequency of noncompliance, would provide such an incentive. Moreover, a penalty provision would clearly indicate the time frame by which Rural/Metro must act to fulfill any penalty obligations that may arise.

Rural/Metro Should Assure That Year 2000 Will Not Impede Fire Protection Services

The City is evaluating its automated systems to assure that all its devices are Year 2000 compliant, so that interruptions in related services do not occur. Year 2000 issues have the potential to interrupt service if computer chips and/or applications are not properly formatted to recognize dates after 1999. For example, the Scottsdale Police Department is evaluating risks associated with the effect of Year 2000 on its CAD. The City's Year 2000 concerns extend to services delivered through contractual arrangements because, if not properly addressed, the services for which *the City bargained could be interrupted.*

Because risks associated with the interruption of fire protection and emergency response is a high priority to the citizens that Rural/Metro serves, Rural/Metro should assure that the Year 2000 issues, as they relate to the delivery of those services, are addressed.

We recommend that Rural/Metro certify, to the City, that services can continue uninterrupted through the change of the century. This certification should include a contract modification that outlines Rural/Metro's responsibility to ensure that its systems and applications are Year 2000 compliant. Additionally, a contingency plan for the provision of service and the proper testing of both the system and the contingency plan should occur prior to June 1999.

Additional Documentation And Consistency In Methodology Would Help In Evaluating The Annual Fee

The City has a fiduciary responsibility to its citizens to verify that its funds are spent in accordance with appropriate authorizations. In the case of the Rural/Metro contract, this responsibility translates into verifying that the annual contract price is accurately calculated per agreed-upon terms. To be able to objectively verify the accuracy of any proposed annual contract price related to a multi-year agreement, the detailed methodology for arriving at the amount needs to be documented in the contract. The lack of sufficiently detailed pricing methodology outlined in the contract could lead to conflicting interpretations of how to arrive at the contract price. For this reason, contract pricing language should be sufficiently detailed to preclude any such conflicts.

Once a pricing methodology is established, related formulas and definitions should also be documented in the body of the contract. Doing so would promote consistency in calculating the amounts. The contract should thoroughly address all necessary information to allow an uniformed party to independently calculate the pricing elements. Once an agreed-upon methodology is established, it should be consistently applied unless modifications to the process are formally adopted.

The contract with Rural/Metro was envisioned to last several years. As a result, a funding plan that outlined the methodology to be used to establish the subsequent fees was developed. Under the funding plan, certain fee elements were to be increased each year to reflect external market forces such as the changes in firefighter compensation at other municipalities, and inflation. To ensure that there was a process available that would adequately control these expenses, the escalation provision for wages was to be replaced with an annual determination of the amount needed each year once a pre-determined funding level was reached. The "other expense" category could be adjusted if the amount exceeded the City's "ability to pay."

While the contract provided for a means to review these fee categories, we found that it does not outline how the pricing determinations were to be made. Because there are many factors that could impact the determination of the amount, the City and Rural/Metro will need to establish a process and written procedures that would facilitate this determination. As part of developing this process, both parties would need to document:

- ♦ The methodology that should be used to determine the wage portion of the contract.
- ♦ A clear definition of obligations of both parties in respect to the cost of maintaining and equipping fire stations and fire apparatus.

In addition, the contract provides Rural/Metro the ability to pass certain costs of fire protection through to the City in the form of additional fees. The contract also provides a mechanism to adjust service levels to meet changing conditions. The Rural/Metro contract provides that the following elements are to be reviewed when the annual fee is calculated:

- ♦ Depreciation.
- ♦ Interest.
- ♦ Response credit/debit.
- ♦ Limited life purchase agreements.
- ♦ Adjusted base and revised service level request.

With the exception of the response credit/debit element, the contract is silent in regard to the methodology to be used to determine these fees. Without such clarification in the contract document, the City has no agreed-upon basis with which to evaluate funding requests for these fees.

We also found that Rural/Metro has been including a service fee in the annual fee request. This fee is not addressed in the contract or related funding plan. There is no documentation that the City agreed to the inclusion of the additional fee, or methodology that discusses the calculation of the amount. When we attempted to determine the methodology used by Rural/Metro, we noticed that the methodology did not appear to be consistent throughout the last six years.

Each of these fee categories will be discussed below.

**Amount Provided For Wages
Appears To Be Reasonable**

The majority of funds provided under the Rural/Metro contract are for the provision of the personnel necessary to carry out the fire protection services. The contract provided for an automatic escalation in the funding of personnel as a means of addressing a wage disparity between Rural/Metro employees and the surrounding municipalities. Rural/Metro staff reported that the goal of wage parity was met during FY 1995/96.

According to the terms of the contract, after wage parity was attained, the amount to be provided for wages was to be determined each year. This provision was intended to end automatic escalation, and to provide the City with the opportunity to assure itself that the amount provided for wages in the Rural/Metro contract, was a reasonable sum to pay for the services received. Adequate determination of the reasonableness of funds provided reduces the risk that the City will pay too much for services

received, as well as reduces the risk that Rural/Metro will not receive sufficient funds.

Because the contract does not contain a clearly defined methodology for arriving at the annual personnel price, we asked Rural/Metro officials for information regarding the cost of providing the employees necessary to support the City contract. Our objective was to use this information to determine the reasonableness of the personnel charges paid by the City in light of Rural/Metro's actual costs. We found that, according to summaries provided by Rural/Metro, the amount of money provided as wages in FY 1994/95 through FY 1996/97 closely mirrored the costs incurred (wages and other payroll-related costs).

Because we were not provided details of items included in the calculations, we could not verify what was considered as a "cost," and could not evaluate reasonableness. Rural/Metro's position is that the amount provided to them for wages does not necessarily reflect actual wages, because it represents the amount that they are willing to provide the personnel for.

We also audited the worksheets prepared by Rural/Metro to calculate the annual fee for the FY's subsequent to the amended contract to verify that the annual escalation was calculated correctly. For those years reviewed, it appeared that the calculation was reasonably correct. We did note, however, that Rural/Metro did not bring forward the correct base wage amount when applying the escalation provision. As a result, the amount requested for wages in the annual fee for FYs 1997/98 and 1998/99 was lower than would have been requested if the correct base had been used.

We could not however, independently determine whether or not the amount of funds requested by Rural/Metro was justified using the terminology contained in the contract. We believe that both the City and Rural/Metro should agree upon and document the methodology to be used annually to determine funding amounts.

**Obligations Of Both Parties In
Regard To Other Expenses
Should Be Adequately
Documented**

In addition to the wage portion, the funding plan provides for a lump sum fee for the "all other contract categories." The portion of this funding escalates each year based on the Phoenix Metropolitan Average Annual Four Quarter CPI. This process has been followed, and over the past five years, the amount has increased an average of 3.9 percent per year. The contract provides the City with the ability to negotiate the amount

provided for these costs, should the request exceed the City's "ability to pay," and states that percent increases in the City "maintenance base" budget are considered as the gauge of ability to pay.

We reviewed the contract language meant to provide a means to evaluate the amount of funding provided for this category and found that it would be difficult to implement for two reasons. First, the City budget is not structured as a maintenance base budget, so increases referred to in the contract cannot be readily identified. The City's operating budget includes funding for new service additions or increased service areas. Second, should the need arise for the Rural/Metro increase to be reviewed, the costs to be included in "other contract categories" have not been defined, and no methodology is provided in the contract to guide the evaluation.

For example, while the contract requires Rural/Metro to maintain and operate a communications center which is equipped and staffed to receive fire and emergency related calls, the contract is silent in regard to whether the expense related to this requirement is to be included under the "all other contract categories." Currently, the City pays Rural/Metro an additional amount for CAD.

Additionally, while the contract requires Rural/Metro to "pay for all vehicles needed to perform staff and ambulance functions and those vehicles needed to perform the function of fire safety education, and fire prevention," it does not say whether the funds provided as "All Other Expense Categories" is meant to cover those types of costs, or whether Rural/Metro can consider these types of equipment purchases an additional cost to be added in the annual fee. Under the current practice, the City is charged an additional amount to cover the cost of acquiring these vehicles (with the exception of ambulances) through the addition of a charge for depreciation.

Another example is the requirement for maintenance at the Fire Stations. The contract states that the City is responsible for maintaining the fire stations and the grounds except as specifically listed. Under the responsibilities of Rural/Metro, the contract states that Rural/Metro is responsible for daily maintenance and minor repairs of the premises. The City and Rural/Metro have interpreted this to mean that the City is responsible for the maintenance of anything that is permanently attached to the building, while Rural/Metro is responsible for the maintenance of portable items. Without a clear distinction in roles and responsibilities, there is a potential for costs to be shifted to other parties or for necessary expenditures to be postponed.

In order for either party to be able to effectively negotiate this amount in the future, should the need arise, Rural/Metro and City staff should agree upon specific performance criteria which could be tied to the level of funding.

**Items Included Under, And The
Calculation Method For,
Depreciation Fees Should
Be Documented**

Each Rural/Metro annual budget request includes funding under a fee category "depreciation." In the accounting profession, the term depreciation refers to spreading out the cost of an item over its estimated useful life, so that annual income takes this long-term cost into consideration. By contrast, according to Rural/Metro officials, depreciation, as it relates to the City contract, is the process used to charge the City for equipment that Rural/Metro acquires to carry out activities, as a means of recovering its cash outlays. The average fee charged during the last three FYs was \$232,000 annually.

Rural/Metro policy is to consider any item, or group of related items, with a cost of more than \$500, to be a capital item. These items or groups of items are capitalized, instead of expensed, and thus are depreciated. Because depreciation is charged to the contract, rather than used solely as an internal management tool at Rural/Metro, Rural/Metro's process directly increases the fee the City pays.

When we reviewed the depreciation schedule used by Rural/Metro to calculate the fee charged to the City, we determined that the City may, through depreciation, pay for items which would be considered normal operating expenses under its own accounting processes. We found items such as staff vehicles, hoses, and other operating equipment were included on the schedule. We also identified items with a cost of less than \$2,000. Current City policy is to capitalize items valued at \$2,500 or over. It also appeared that Rural/Metro was grouping the acquisition of items. As a result, we could not determine whether the decision to record the item was based on individual cost, or cost of the group.

This method of calculating the amount requested for depreciation appears to be in conflict with other contract terms which could be interpreted to mean that Rural/Metro has an obligation to provide certain equipment without additional funds from the City. Contract terms regarding equipment purchases are shown in the Insert on the next page. To avoid differences in opinion regarding the inclusion of a charge for depreciation in the annual fee, both the City and Rural/Metro should agree and document the entire understanding regarding this additional fee.

Contract Provisions Which Control Equipment Purchases

- ◆ The City will purchase equipment with a value of over \$2,000 and a useful life of five years or more.
- ◆ The City must agree to fire apparatus or emergency vehicle purchases for which it will pay, prior to the purchase.
- ◆ Rural/Metro must provide staff vehicles, ambulances, and vehicles needed for fire safety education and fire prevention.
- ◆ Rural/Metro shall pay for equipping and purchasing all miscellaneous fire-related and emergency equipment.
- ◆ The City may reimburse Rural/Metro for purchases in excess of \$1,000, with City approval.
- ◆ All purchases over \$1,000 shall be coordinated through the City, and shall adhere to the City Procurement Code.

SOURCE: City's Rural/Metro contract.

As well, an issue exists regarding equipment ownership. Generally, if the City pays for a capital item used by a contractor to perform an activity or service, there should be an expectation of ownership. Ownership would save the City from re-purchasing the item should the contractor cease providing the service. In addition, there should be an expectation of receiving any funds from the sale of the item when it is removed from service, or, in the case of Rural/Metro, transferred to other divisions. The contract also should require Rural/Metro to assure that items continue to be used for service delivery by including them on the annual inventory of items owned by the City, but controlled by Rural/Metro.

**Interest Fees Passed Through
To The City Should Be
Documented**

Normally, interest is charged to an organization as a cost of acquiring financing. Interest is tied to a specific amount of money, a specific rate which is agreed to at the inception of the agreement, and a specific period of time. Organizations evaluate the cost of interest in deciding whether or not to incur the financing. According to Rural/Metro officials, the term interest as it relates to the contract, is Rural/Metro's carrying charge. This fee is meant to cover the cost of advancing the money used to pay for capital items, through the period it takes Rural/Metro to recapture costs from the City.

We reviewed the contract language relating to this additional fee and found that normal controls which the City could use to manage these charges are not documented. Parameters regarding instances in which interest charges to the City would be justified, or an interest rate ceiling, have not been documented. According to Rural/Metro officials, the methodology used to arrive at this fee consists of multiplying the net book value of capital assets (i.e., equipment purchase price less the amount already charged to the City) by a rate of 12.45 percent.

We believe that, in order to provide a basis for determining the interest charge, the following items should be agreed upon and documented in the contract:

- ♦ The manner by which the applicable rate of interest will be determined.
- ♦ The cap on how high the rate can go.
- ♦ The payback period to which interest will apply.
- ♦ The methodology to be used to arrive at the total interest charge.

**The Methodology Used To
Arrive At The Response
Debit/Credit Should Be
Periodically Evaluated**

As mentioned earlier, the "response debit/credit" fee element is the only one of these additional fees for which the contract provides guidance regarding the calculation. According to Appendix D of the contract, Rural/Metro may use City-dedicated personnel and apparatus, if needed, to respond to other jurisdiction emergencies. Correspondingly, Rural/Metro may need to move personnel and apparatus from other jurisdictions into the City to respond to a high service need. To address the costs associated with the use of these resources, the contract outlines the process to be used to calculate any additional fee or credit.

The methodology outlined in the contract requires the charge or credit to be calculated based on the average cost per call. Average cost per call is calculated by dividing the annual fee by the total number of incidents. This amount is then multiplied by the net of the calls out of the City, and the calls in the City. If there are more calls out of the City, there is a credit applied in the annual calculation. More calls in would result in a charge.

While this methodology is simple to implement, it does not take into consideration the types of calls, number of units responding, or the time involved. As a result, the calculation may not actually reflect the cost associated with the call. For example, more than 60 percent of the calls associated with the City contract are in response to emergency medical

services. These types of calls may not be as time consuming and costly to respond to, compared to the incidents in which Scottsdale resources are needed in other jurisdictions.

In order to more accurately judge whether the City is receiving sufficient compensation or paying a justified additional fee, the City and Rural/Metro should track the resources, both equipment and personnel, needed to provide this service and compare that to the calculation outlined in the contract. If there is a significant difference between the cost and the adjustment, then a new methodology should be developed. In addition, Rural/Metro should consistently provide the City's Contract Administrator with reports relevant to the response debit/credit calculation, as required by the contract.

**Limited Life Purchase
Agreements Should Be
Sufficiently Documented**

According to City staff and Rural/Metro officials, additional fee categories were developed as a means of bringing some flexibility into the funding arrangement without having to change the contract funding plan. The category "Limited Life Purchase Agreements" is an example of this type of fee category. According to the City Contract Administrator, a Limited Life Purchase Agreement was used as a means for the City to participate in the cost of Rural/Metro's CAD. In 1991, Rural/Metro purchased a new CAD with a life expectancy of 5 years. A portion of the purchase price was allocated during each subsequent year, and charged to the City as a limited life purchase based on the percent of calls. As a result, the City paid an additional amount of between \$20,400 to \$26,000 through FY 1995/96 for the CAD purchase. We could not locate any documentation regarding the terms and conditions of the Limited Life Purchase Agreement.

In 1996, the Contract Administrator approved the City's continued participation when Rural/Metro acquired a new CAD. Under this current agreement, the City will pay a percent based on calls through FY 1999/00. Based upon a payment made in FY 1996/97 of \$21,760, we calculated that it appears that the base amount allocated in FY 1996/97 was \$100,000.

The documentation of the City's participation in the cost of the new CAD is limited to an informal letter signed and dated by the Fire Chief and the Contract Administrator. Prior to any further agreements regarding limited life purchases under this category, the City should evaluate the need for, and document the research undertaken to determine the need for, participating in the purchase. The Limited Life Purchase Agreement should be formalized, with the terms and conditions adequately

documented and appropriately authorized. The current agreement does not state the total cost which is the basis for the City's participation, nor are costs which are passed through controlled by appropriate language.

**Increases In Base Fees And
Service Level Adjustments
Should Be Evaluated Prior To
Approval, And Implemented
Consistently**

The last category of additional fees provides for adjusted base and revised service levels. The price established in the initial year of the contract was based on the service levels then necessary to adequately address the needs of the City. Because both parties recognized the need for a process to provide for service level increases, the contract provides for adjusted base and revised service level requests to be considered during the normal City budget process. Under the current process, once a request for service level increase is approved, the service level charge is rolled into the fixed-fee portion of the contract, and is subject to the annual wage escalation.

This provision has been followed, and over the course of the last five years, the contract service levels have been increased for the addition of two new fire stations, a plan reviewer, and two deputy fire marshals. The impact of the wage portion alone, for these service level increases, on the FY 1997/98 contract price is approximately \$1.73 million.

While the contract allows for the increase, we found that it does not outline the methodology to be used when determining the amount of increase. Specific performance criteria related to the increase is not documented. For example, with a request for additional funding for new staff, the approval of the funding should be tied to analysis of the following elements:

- ♦ Job descriptions.
- ♦ A pre-determined number of staff positions.
- ♦ Estimated time devoted to the contract (full-time, part-time, dedicated to the contract or shared with other responsibilities of the service provider).
- ♦ Job qualifications.
- ♦ A set date for the service to begin.

After a review of this information, both parties would then agree on the amount to be included in the fee. With this method, the City could then ask for verification that the additional staff met the qualifications and were hired at the appropriate time.

In addition to performance criteria, other issues that affect the amount of the service level increase should also be addressed prior to approval. For example, there should be an agreement on the additional costs such as benefits and administrative fees. The impact on future costs should be examined as well. For example, when calculating the base for the current year, a decision should be documented regarding whether or not the additional funding is added prior to, or after, any escalation.

In absence of contract requirements, the normal City budget process is used to determine whether the request for additional personnel or staffing should be approved. If the request is approved, then the contract is adjusted by the amount Rural/Metro requests. According to Rural/Metro staff, additional funding requested for service level increases is based on the mid-range salary for the additional personnel needed. This amount is then increased by a percent for benefits and administrative costs. Under this arrangement, Rural/Metro assumes the risk of having to hire someone at a higher salary. Correspondingly, they also benefit if they hire someone at a lower salary, or at a point later in the FY.

The methodology used by Rural/Metro is similar to that used by the City for increased staffing, with one major difference. While both parties assume the risk of hiring someone at a higher salary level, City departments who hire new staff at a lower level must either re-program salary savings into the next budget year or, if approved by the City Manager, use the savings for some other needed expense. When the City department budget is prepared for the next year, the salary allocation is automatically set at the actual salary and benefit cost for the new employee. This limits any potential salary savings resulting from a new hire to the first year.

Just as there is a potential for salary savings, Rural/Metro, if they choose, could bring new hires in at a level greater than the mid-point, for example, if they transferred someone in from another division. However, caution should be used when considering whether this is a risk which concerns the City. If Rural/Metro chose to transfer someone with a higher salary level into a City-funded position, Rural/Metro potentially could replace that position with a lower-level new hire. This would allow the higher expense position to be shifted to the City contract, and reduce expenses in another Rural/Metro division.

During discussions with City staff and Rural/Metro officials, some differences in understanding were apparent regarding the intent of the contract. City staff indicated that the service level increase was meant

to reflect the amount that actually would be paid by Rural/Metro to provide the new staff. Rural/Metro officials indicated that the service level increase was the amount for which Rural/Metro was willing to provide the staff. The City should have no expectation that the amount charged to the contract would be related to the amount Rural/Metro actually expended to provide the personnel.

Regardless of which understanding is correct, the City and Rural/Metro need to agree to and document the methodology for the service level increase. Three alternatives exist. The first is to continue the current method. If both parties choose this, the City should understand the potential effect on future costs, and accept the risk. A second alternative would be for the City and Rural/Metro to agree on and document a set amount per position as discussed earlier in the section regarding wages.

A third alternative is for Rural/Metro to document the actual cost of providing the additional staff. The City and Rural/Metro would agree in advance about the amount to be added for benefits and administrative costs. By documenting the agreed upon method, the process becomes a normal City budget request. Rural/Metro can then submit worksheets indicating the salary for the increased staffing, the agreed upon percent for benefits and administrative costs, and the anticipated date of hire. The next budget year would then be adjusted to reflect the amount of salary that will actually be paid.

**“Service Fee”
Appropriateness
Should Be
Re-evaluated, And
If Continued, Fee
Calculation Method
Should Be
Consistent**

According to the contract, the City and Rural/Metro entered into a “fixed fee” contract as an incentive for Rural/Metro to be an efficient and effective service provider. True fixed fee contracts, once negotiated, require only oversight of service delivery. By contractually establishing a firm price for service delivery and the associated performance measures, any risk associated with the cost of providing the service is shifted to the contractor. This allows the City to focus on the outcome of the contractual arrangement, not the cost incurred to provide the service. The contractor has the incentive for efficient and effective service delivery, in order to maximize any profit.

Based upon our audit, we concluded that the Rural/Metro contract is not fixed fee. Funding for elements such as personnel and other commodities escalates from a base amount, and is not re-negotiated each year. Other expenses which are documented in the contract allow Rural/Metro to calculate actual costs, and increase or decrease the amount requested every year. Another reason that we concluded that the contract is not

fixed fee is Rural/Metro's inclusion of a "service fee" in the annual fee calculation submitted in the City budget process. This fee is not documented in the Rural/Metro contract, and is not normally included in fixed fee contracts. Providing guaranteed profit in the form of a service fee reduces any incentive for efficient and effective service delivery.

We believe that the propriety of continuing to pay the service fee needs to be evaluated. In addition, if the service fee is retained, the methodology used by Rural/Metro to calculate the fee from year to year should be consistent and documented in the contract.

**Allowance Of A "Service Fee"
Should Be Re-evaluated**

According to professional literature, fixed price contracts do not include a service fee because there is an expectation that an amount of profit is taken into consideration when the fee is set. As discussed above, a fixed fee contract provides incentive for the service provider to be efficient and effective in order to maximize the element of profit.

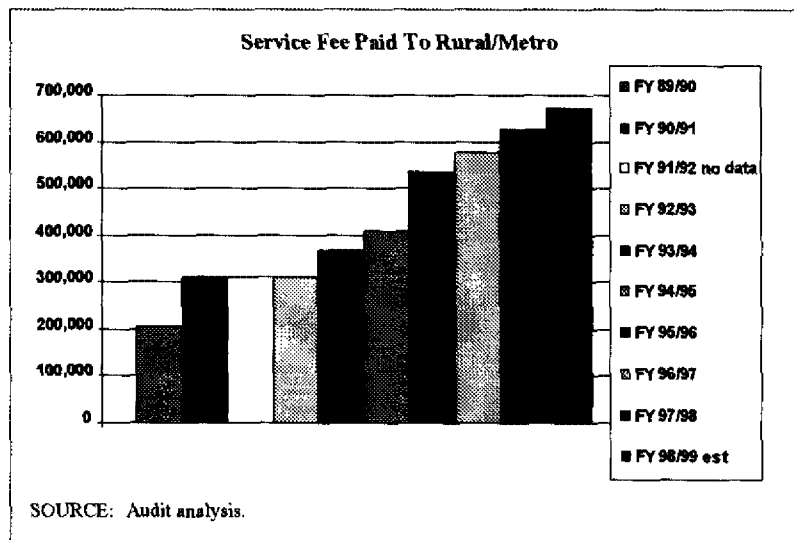
By contrast, a service fee is added to a "cost plus" contract as a means of providing a guaranteed level of profit. These types of contracts are usually entered into when the scope of service is difficult to define prior to the award of the contract. The contractor is then required to document the actual cost of providing the service to avoid the potential for profit to be included in the direct costs as well as the service fee. Through this process, the actual cost of providing the service is passed through, and the service provider is paid a pre-determined fee.

Most cost plus contracts set a limit on the service fee that will be earned in order to avoid the potential of incurring uncontrolled expenses which *inflate the fee. This does not provide an incentive for efficiency and effectiveness, but does assure that the service provider does not receive an exaggerated profit from the arrangement.*

In addition to items allowed by contract, Rural/Metro is including a service fee which, although it is not provided for in the contract, has been approved as a part of the budget in past years. We do not believe that the inclusion of a service fee is justified, because Rural/Metro already has the opportunity to profit from efficiently and effectively providing the contract services. Contract fees not expended by Rural/Metro are moneys retained for Rural/Metro's benefit (i.e., profit).

Also, by allowing Rural/Metro to include a service fee which is based on the total contract amount, the cost of any item charged to the contract is

increased by the amount of the service charge. When Rural/Metro purchases equipment such as a fire truck, it is included on the depreciation schedule (which means that the City pays an additional amount each year for that equipment). Not only will the City pay for the equipment through depreciation, but also the City pays for the cost of financing the equipment, and the cost of the service fee. The chart below shows the service fee paid to Rural/Metro for the past 10 years.



If the City and Rural/Metro agree that a service fee is justified, the City should consider a cap on the amount as protection against unanticipated changes in Rural/Metro responsibilities and/or service levels which would have the potential to significantly increase the service fee. Without a cap, the service fee could rise beyond what may be considered a reasonable level. Additionally, the amount and the method of calculating the fee should be documented in the contract.

**If Retained, The Fee Should Be
Calculated Consistently**

Rural/Metro's calculation of the service fee has not been consistent during the past five years. For example, in FY 1992/93, the service charge included in the contract total was \$311,269, which is approximately 5.4 percent of the contract total prior to the inclusion of the service charge. In FYs 1993/94 and 1994/95, the service charge was 5.5 percent of the contract total prior to the inclusion of the service charge. In FY 1995/96, and for each year since then, the 5.5 percent service charge was based on the entire contract. As a result of the change in methodology, the service fee paid to Rural/Metro increased by almost \$30,000 for the initial

year, and by more than \$30,000 for each subsequent year. The Insert below demonstrates the calculation methodology since the revision.

Rural/Metro Service Fee Calculation Fiscal Year 1995/96			
	<u>Revised</u> <u>Methodology</u>	<u>Previous</u> <u>Methodology</u>	<u>Difference</u>
Payroll	\$7,019,945	\$ 7,019,945	\$ 0
Commodities	1,894,791	1,894,791	0
Interest	131,151	131,151	0
Depreciation	226,659	226,659	0
CAD Purchase	23,670	23,670	0
Response Credit	(85,560)	(85,560)	0
Subtotal	\$9,210,656	\$9,210,656	0
Service Fee	536,070 ¹	506,586 ²	\$29,484
Total	<u>\$9,746,726</u>	<u>\$9,717,242</u>	<u>\$29,484</u>
1) $\$536,070/\$9,746,726 = 5.5\%$			
2) $\$506,586/\$9,210,656 = 5.5\%$			
SOURCE: Audit analysis.			

If the City decides that continuing to pay the Rural/Metro service fee is appropriate, the methodology by which the fee is calculated should be documented in the contract, so that the fee is calculated consistently from year to year.

The City Should Implement Controls To Adequately Monitor Additional Expenses

In addition to the previously mentioned costs which are added to the contract, the City incurs other costs associated with providing fire protection services. These additional costs include:

- ◆ Supplies, such as those needed for hazardous waste removal, and specialty teams, which are consumed by Rural/Metro employees.
- ◆ Providing air compressors, emergency power generators, and equipment necessary for specialty teams, such as underwater recovery equipment.
- ◆ Maintenance and repair of facilities.
- ◆ Maintenance and repair of City-owned equipment and apparatus.

Under terms of the contract, the City is responsible for providing all supplies necessary for the specialty teams (hazardous waste removal, for example) and providing certain required equipment. In addition, the City provides for maintenance and repair of the fire stations using either City employees or contractors. For City-owned equipment and apparatus, Rural/Metro staff handle the repair and maintenance, but bill the City for those services. Other provisions also provide for the City to reimburse Rural/Metro for disposable supplies at the City's discretion.

We reviewed applicable contract language and determined that sufficient guidance is not documented which would allow the City the ability to adequately control these additional expenses. For example, while the contract provides that Rural/Metro is responsible for fire stations' physical damage resulting from its "negligence or lack of ordinary care," Rural/Metro is not required to ensure that their employees use their best efforts to reduce major maintenance needs. Rural/Metro employees may elect not to perform minor repairs which are their responsibility, resulting in more costly repairs by the City.

Similarly, the contract does not provide the City with recourse against Rural/Metro for inadequate preventative maintenance or care of City-owned equipment such as the large fire apparatus. The contract provides for Rural/Metro employees to perform preventative maintenance, as well as other needed repairs, on City-owned large fire apparatus, and then to bill the City for those services. The contract does not address whether or not the City should be responsible for the cost of repairs which are the result of insufficient or inadequate preventative maintenance or of mechanic error. As a result, the City may be billed the cost of repairs which were caused by Rural/Metro employees, or which could have been prevented.

Under the terms of the contract, the Contract Administrator also can authorize reimbursement to Rural/Metro for purchases of disposable supplies used in day-to-day operations. However, the contract does not establish criteria that would allow consistent determinations as to whether or not to reimburse Rural/Metro for items under this provision.

In order to more effectively control these types of cost in the future, the City should implement additional documentation of both the costs and the needs. The Contract Administrator should periodically review Rural/Metro's preventative maintenance with City staff knowledgeable in such matters for trends which may impact the cost to the City, or to identify

changes which could lower future costs.

In addition, for those supplies and equipment which the City agrees to acquire, or reimburse Rural/Metro for, the Contract Administrator should document, on a case by case basis, the reason the City should incur the expense. Rural/Metro should be required to certify that the items purchased with City funds were used in the normal course of providing fire protection services within Scottsdale city limits, and that the cost of such supplies will not be passed on through other Rural/Metro fees and charges.

RECOMMENDATIONS

The City Manager should require:

1. The Contract Administrator to obtain all contractually required reports from Rural/Metro.
2. Development of a performance criterion for use in assessing the total Rural/Metro response time, unit notification to arrival on scene.
3. The Contract Administrator to maintain and update the contract document to reflect additions and changes to the contract terms.
4. Development of penalties for noncompliance with contractually required performance criteria.
5. Certification that Year 2000 issues will not interrupt services provided to the City, through modifying the contract, and development of a City contingency plan in the event of failure.
6. Development of a process to stringently review the annual cost of fire and emergency services, including clarifying the methods, definitions, terms, and formulas to be used in calculating the annual fee, such as including a clear distinction in maintenance roles and responsibilities; specific performance criteria which could be tied to the level of funding; depreciation; equipment ownership and disposal funds from the sale or transfer of equipment; interest charges; response debit/credit amounts; and Limited Life Purchase Agreements.
7. Development and documentation of methodology for calculating the service level increases.

8. Evaluation of the need for allowing Rural/Metro to include a service fee in the annual fee, and if approved, require documentation of the methodology.
9. Documentation of the justification for other related costs such as consumable supplies. Rural/Metro should be required to certify that the items purchased with City funds were used in the normal course of providing fire protection services within Scottsdale city limits, and that the cost of such supplies will not be passed on through other Rural/Metro fees and charges.

ABBREVIATED RESPONSES

The City Manager responded that he agreed with the report's recommendations, and that actions were underway to address the issues raised in the report.

The Rural/Metro Executive Vice President responded that he believed that a six-person team should be formed specifically to negotiate agreement on the nine issues outlined in the report, which would report to the City Auditor's Office with findings and recommendations.

APPENDIX

Evaluation of Rural/Metro Contract Compliance
City Auditor Report No. 9406

A

Objectives, Scope, And Method

The purpose of this audit was to gain insights that may be used to strengthen and refine the contract document and its administration within the City and to verify Rural/Metro's compliance with significant performance measures set out in the contract. The audit was not intended to evaluate Rural/Metro's operations. We did not examine or comment on the quality of the services provided by Rural/Metro. Audit work was conducted in accordance with generally accepted government auditing standards as they relate to expanded scope auditing in a local government environment and as required by Article III Scottsdale Revised Code §2-117 *et. seq.*, except that the Office currently does not comply with the requirement regarding peer review frequency.

To gain an historical perspective on the City's relationship with Rural/Metro, we reviewed the current contract document as well as previous contract generations. We also reviewed a 1989 outside consultant's report which evaluated the fire and emergency services provided to the citizens of Scottsdale. Additionally, we interviewed City and Rural/Metro personnel to obtain their perspective on the evolution of the relationship.

In reviewing the contract document, we identified significant terms requiring specific Rural/Metro performance as well as other language critical to the administration of the contract. We interviewed City and Rural/Metro personnel, involved with the administration of the contract, to obtain information and supporting documents regarding contract implementation. Through our interviews and inspections of related documents, we identified controls used by the City's Contract Administrator to verify and ensure Rural/Metro compliance with significant contract terms. Using this information, we performed a risk analysis to identify weaknesses in the control environment. Based on this analysis, we developed tests designed to determine whether Rural/Metro was in compliance with significant contract requirements. The tests were also designed to provide insight into the effectiveness of the City's administration of the Rural/Metro contract.

To verify that Rural/Metro employees held contractually required certifications, we selected a judgment sample of employees to review. We reviewed Rural/Metro's records to identify the level of certification for the sample employees. We then verified the accuracy of Rural/Metro's information by obtaining certification information from the appropriate authorizing offices. To verify that the 9 Rural/Metro

firefighters, selected in the sample, held at least a Firefighter II certification, we contacted the Arizona State Fire Marshall's Office and obtained that information. To verify that the 10 Rural/Metro firefighters, selected in this sample, held at least an *Emergency Medical Technician* certificate, we contacted the Arizona Department of Health Services and obtained the necessary information. Additionally, to verify that Rural/Metro employees received the minimum level of annual training required by the contract, we selected a judgment sample of 12 Rural/Metro firefighters for whom we reviewed Rural/Metro's FY 1995/96 training records. We also reviewed the FY 1994/95 training analysis performed by the Insurance Services Office on a sample of 19 Rural/Metro firefighters.

To verify Rural/Metro compliance with contractually required response times, we reviewed related Contract Administrator records. We also interviewed Rural/Metro employees responsible for generating response time reports, and we examined the automated edits used in report generation. We then compared the logic of the automated edits to the response time criteria contained in the contract and noted inconsistencies. We then obtained, from Rural/Metro, a CAD report of Rural/Metro's response time performance for the 3-month period beginning September 1, 1996, and ending November 30, 1996. There were a total of 3,099 calls listed on that response time report. We reviewed the out-of-chute response times indicated on the report and noted instances of non-compliance with the respective contract requirements.

To determine the accuracy of contract pricing, we reviewed related contract terms and noted whether the language was sufficient to provide clear formulas and methodologies for calculating the amounts. We interviewed Rural/Metro and City personnel to determine the actual methods and formulas used to arrive at the annual contract price and to determine what is done to verify the accuracy of the calculations. We reviewed Rural/Metro's supporting documentation for the depreciation and interest charges included in the contract price. We verified that the depreciation and interest were calculated in accordance with Rural/Metro's stated methodology, and then compared the methodology to that contained in the contract as well as to the City's practice for calculating like amounts. We also obtained Rural/Metro's contract budget worksheets, beginning with FY 1992/93 and ending with FY 1998/99, to obtain insight into the elements that factor into the annual pricing of the contract. We compared the pricing elements on these worksheets to the pricing elements referenced in the contract in order to identify any inconsistencies. To verify the justification for increases to the wage portion of the contract price, we obtained and reviewed the "Arizona

Public Safety Survey” for the FYs beginning with 1992/93 and ending with 1996/97. From these reports we obtained the average firefighter wage increases for the fire departments referenced in the contract. We then determined whether these average increases supported the increases provided to the wage portion of the Rural/Metro contract price.

APPENDIX


Evaluation of Rural/Metro Contract Compliance
City Auditor Report No. 9406

B

Management Responses

1. Memorandum from the Scottsdale City Manager
2. Memorandum from the Executive Vice President, Rural/Metro

Response From Scottsdale City Manager

Date: August 20, 1998
TO: Cheryl Barcala, City Auditor
FROM: Richard A. Bowers, City Manager 
SUBJECT: Management Response: Audit Report #9406-"Evaluation of Rural Metro Contract Compliance"

Thank you very much for the above referenced report and associated recommendations.

Annual surveys and other ways we receive feedback from citizens and customers show a high level of satisfaction and confidence in services provided by Rural Metro Corporation.

City management has reviewed your audit findings and recommendations. We are in agreement with said recommendations and will respond in the following manner:

- A management oversight team is being formed. This team will serve as a resource to those most directly responsible for compliance monitoring, routine administrative activities, strategic planning and support for the contract negotiation process. Our community continues to grow in size, demands and complexity. The intent is to respect and honor our historically effective partnership with Rural Metro Corporation and to strategically respond to an ever changing business and service environment. This team will begin its work no later than September 1, 1998. Suggestions for implementation of audit recommendations will be incorporated into its overall work plan, and ultimately forwarded to me.
- Ongoing discussions will occur between Rural Metro Corporation and the City of Scottsdale regarding appropriate ways to implement specific recommendations and other mutually agreed upon or potential modifications to the existing agreement.
- Policy direction and decision making will be actively sought and complied with whenever necessary and appropriate.

Thanks, once again, to you and your team for your emphasis on quality and your cooperative approach to the work you do on behalf of our leadership and community.

Cc: Robert Edwards, Executive Vice President, Rural Metro Corporation
Doug Bartosh, Chief of Police
Marc Eisen, Director of Emergency Services
David Ellison, Assistant City Manager

Responses From Rural/Metro Executive Vice President



The premier provider of
health and safety solutions

September 2, 1998

Dick Bowers
Scottsdale City Manager
City of Scottsdale
3939 Civic Center Blvd.
Scottsdale, Arizona 85251

RE: EVALUATION OF RURAL/METRO CONTRACT COMPLIANCE

First I would like to compliment the City auditor and her staff for the in-depth study of the fire and emergency medical service provided to the citizens of Scottsdale for over 48 years.

Reviewing a system that is not part of a traditional management system of the City must have been a challenge in its self.

The report outlines nine areas that in the opinion of the City auditor and her staff need further evaluation by both the City and Rural/Metro Corporation.

I would like to suggest forming a team consisting of six members—three from the City of Scottsdale and three from Rural/Metro. I would suggest the following team members:

City of Scottsdale

1. David Ellison, Deputy City Manager
2. Doug Bartosh, Police Chief
3. Marc Eisen, Contract Administrator

Rural/Metro Corporation

1. Bob Edwards, Executive Vice President
2. Karl Kelerleber, Fire Chief
3. Jim Ford, Fire Marshal

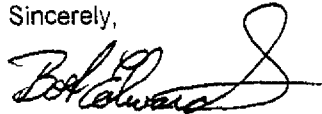
8401 E. Indian School Rd. Scottsdale, Arizona 85251
Phone (602) 994-3886 Fax (602) 481-3328

I believe that this group can come to agreement on the outstanding points outlined in the report. This team would report back to your office with its findings and recommendations.

The City of Scottsdale contract is still, and always will be, Rural/Metro's flagship operation. Rural/Metro owes a large part of what it is today to the vision and willingness of past and present city councils to allow our public/private partnership to grow with the City of Scottsdale.

I personally believe that without the leadership provided by yourself as the CEO of the City, this partnership would not have survived the rough waters of the past. Looking forward to our continuing relationship for many years to come.

Sincerely,



Bob Edwards
Executive Vice President

c: Cheryl Barcala, Scottsdale City Auditor